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Using a Shotgun to Kill a Fly: Issues with the CFPB's Payday Lending Proposal and the Need to Incentivize Banks to Enter the Marketplace

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I. INTRODUCTION

Credit is a vital mechanism for consumers living paycheck to paycheck coping with shortfalls in income.[1] Such shortfalls can arise from numerous situations, including unexpected expenses, emergencies, and mismatched timing between income and expenses.[2] Borrowing against future income is a common practice, and payday lenders serve consumers lacking the income necessary to adequately cover financial needs.[3]

Payday lenders are "central figures in the fringe banking industry."[4] The payday lending industry has more locations than McDonald's,[5] extends over $38 billion in credit per year to individuals in 19 million households, employs over 50,000 workers, and generates over $2.5 billion annually in tax revenue.[6] Supporters of payday lending praise both the speed at which payday loans can be executed as well as the availability of payday loans to those unqualified for alternative forms of credit.[7] On the other hand, opponents of payday lending are concerned with borrowers' ability to repay payday loans on time while also covering basic living expenses, in addition to the

1. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,866 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041).

2. *Id.*

3. Creola Johnson, *Payday Lending: Shrewd Business or Predatory Lending?*, 87 MINN. L. REV. 1, 11 (2002).

4. *Id.* at 8.

5. Jeff Cox, *There are More Payday Lenders in U.S. Than McDonald's*, NBC NEWS (Nov. 24, 2014), http://www.nbcnews.com/business/economy/there-are-more-payday-lenders-u-s-mcdonalds-n255156.

6. *About the Payday Advance Industry,* CMTY. FIN. SERVICES ASS'N OF AM., http://cfsaa.com/about-the-payday-advance-industry.aspx (last visited Jan. 18, 2016).

7. CONSUMER FIN. PROT. BUREAU, PAYDAY LOANS AND DEPOSIT ADVANCE PRODUCTS: A WHITE PAPER OF INITIAL DATA FINDINGS 3 (2013), https://s3.amazonaws.com/files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

aggressive debt collection practices payday lenders employ.[8]

The Consumer Financial Protection Bureau's ("CFPB") proposed rule on Payday, Vehicle Title, and Certain High-Cost Installment Loans (the "Proposal") aims to regulate, among other types of financing, payday loans.[9] As of October 2016, the CFPB had received close to one million comments regarding the Proposal, far more than any other proposal in the agency's history.[10] This Note proceeds in six Parts. Part II examines the operation of payday loans and outlines several of the major consequences borrowers face when taking out such loans.[11] Part III describes the Proposal and the requirements it imposes on lenders.[12] Part IV analyzes the Proposal in light of its goals of eliminating predatory lending practices and providing consumers with safe access to credit.[13] Part V discusses how regulators can incentivize traditional banks to enter the payday loan marketplace, whether through modifications to the Proposal or other mechanisms.[14] Part VI concludes this Note by summarizing the Proposal's deficiencies and banks' abilities to replace payday lenders.[15]

II. THE BUSINESS OF PAYDAY LENDING

Payday loans are easy to acquire, and payday lenders infrequently perform due diligence in determining whether a borrower will be able to repay a loan on time.[16] As a result, significant numbers of unqualified borrowers take out payday loans they are unable to repay on time, leading borrowers to extend their loans and eventually become

8. *Id*.

9. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,867 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041) ("This rulemaking is focused on . . . short-term loans. The largest category of short-term loans are "payday loans," . . . and short-term vehicle title loans . . . .").

10. Yuka Hayashi, Rachel Witkowski & Gabriel Rubin, *Dueling Payday-Lending Campaigns Deluge CFPB With Comments*, WALL ST. J. (Oct. 10, 2016), http://www.wsj.com/articles/dueling-payday-lending-campaigns-deluge-cfpb-with-comments-1476131725?mg=id-wsj.

11. *See infra* Part II.

12. *See infra* Part III.

13. *See infra* Part IV.

14. *See infra* Part V.

15. *See infra* Part VI.

16. *See* Johnson, *supra* note 3, at 10 (listing the few requirements of applying for a payday loan).

trapped in a cycle of debt.[17] Further, payday lenders have a history of targeting low-income individuals and engaging in aggressive and predatory debt collection practices.[18] This Part discusses how payday loans operate and outlines some of the major consequences to borrowers, including the debt cycle borrowers often fall into, aggressive debt collection practices, and attempted regulation of payday lending at the state level.

A. The Operation of Payday Loans

Payday loans are short-term, high-cost loans where a borrower provides a post-dated check or access to a debit account in exchange for immediate cash.[19] Applying for a payday loan is a simple process that contains only a few requirements.[20] Unlike more traditional loans, payday lenders do not require collateral, consider the borrower's other financial obligations, or check the borrower's credit score.[21] Borrowers simply promise to repay the principal in full plus a fee.[22] The fee accompanying a payday loan is generally 10–20% of the principal borrowed,[23] which can lead to an annual percentage rate ("APR") as high as 400%.[24]

A dangerous feature of payday lending is the ability of borrowers to extend loans,[25] increasing the costs of borrowing and

17. *Id.* at 3–4.

18. *See id.* at 11 (noting that payday lenders serve a class of borrowers with low incomes and no savings and do not accept partial payments for repaying loans).

19. Michael Kenneth, *Payday Lending: Can "Reputable" Banks End Cycles of Debt?*, 42 U.S.F. L. REV. 659, 660 (2008).

20. *See* CONSUMER FIN. PROT. BUREAU, *supra* note 7, at 8 (highlighting the ease at which consumers can acquire a payday loan).

21. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,872 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041); CONSUMER FIN. PROT. BUREAU, *supra* note 7, at 9. *But see, e.g.*, UTAH CODE ANN. § 7-23-401 (West 2016) (requiring lenders to ensure the borrower has the ability to repay the loan); MO. REV. STAT. § 408.500(7) (2015) (requiring lenders to consider a borrower's ability to repay the loan, but does not specify how a lender may satisfy this requirement); WIS. STAT. § 138.14 (2016) (prohibiting loans exceeding a certain percentage of a borrower's gross monthly income).

22. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47869.

23. This amounts to $10 to $20 per $100 borrowed. *Id.* at 47867.

24. *Id.* at 47,868.

25. Patrick Hayes, *A Noose Around the Neck: Preventing Abusive Payday Lending Practices and Promoting Lower Cost Alternatives*, 35 WM. MITCHELL L. REV. 1134, 1142

creating the "debt cycle" trap that the Proposal aims to eliminate.[26] If a borrower is unable to repay a payday loan when it is due, he may pay an additional fee to "roll-over" the loan to extend the due date.[27] The roll-over fee is usually equal to the initial fee to receive the loan.[28] A borrower remains indebted until he repays the principal plus any costs and interest.[29] Lenders typically refuse to accept partial payments for the principal, forcing borrowers to extend loans until they can repay the entire balance in one payment.[30] The roll-over process can trap the borrower in a cycle of debt, with the borrower repeatedly extending a loan and incurring additional fees and the lender content to keep the principal unpaid.[31] The danger of the roll-over feature is displayed in a study conducted by the Center for Responsible Lending ("CRL"), which found that although borrowers had an average loan amount of only $350, borrowers in the study paid a median total of $458 in fees and one in four borrowers paid at least $781 in fees.[32]

Supporters and opponents of payday lending both acknowledge that repeat borrowers are critical to the payday lending business model.[33] Dan Feehan, former CEO of payday lender Cash America, once stated that "the theory in the business is you've got to get that customer in, work to turn him into a repetitive customer, long-term customer, because that's really where the profit is."[34] Payday lenders employ a variety of techniques to encourage repeat borrowing.[35] Some lenders instruct employees to pressure customers into borrowing more,[36]

(2009).

26. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47,926.

27. Kenneth, *supra* note 19, at 660.

28. Johnson, *supra* note 3, at 10–11.

29. Johnson, *supra* note 3, at 11

30. Kenneth, *supra* note 19, at 660.

31. Heather L. Petrovich, *Circumventing State Consumer Protection Laws: Tribal Immunity and Internet Payday Lending*, 91 N.C. L. REV. 326, 331 (2012).

32. Thomas Edsall, *Making Money Off the Poor*, N.Y. TIMES (Sept. 17, 2013, 10:48 PM), https://opinionator.blogs.nytimes.com/2013/09/17/making-money-off-the-poor/?_r=0.

33. *See, e.g.*, Nathalie Martin, *1,000% Interest – Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 573 (2010); Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,874 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041) (noting that payday lending is "dependent upon a large volume of reborrowing").

34. Edsall, *supra* note 32.

35. Martin, *supra* note 33, at 573.

36. Martin, *supra* note 33, at 575.

while others provide monetary incentives rewarding employees and store managers for loan volumes.[37] One participant in a study claimed that if a customer paid off the interest on time five times in a row, the customer would receive the sixth interest payment at half price.[38] The combination of low-income borrowers' desperate need for credit and payday lenders propensity to encourage repeat borrowing creates a dangerous treadmill of debt, often leaving struggling borrowers worse off than they were prior to receiving a payday loan.[39]

B. Predatory Lending Practices and State Regulatory Reponses

Payday lenders have a history of targeting low-income individuals.[40] Payday loan borrowers typically have incomes in the range of $25,000–$30,000, poor credit histories, and have often repeatedly sought credit in the months leading up to the decision to take out a payday loan.[41] Additionally, borrowers have often filed for bankruptcy either before or after taking out a payday loan.[42] Payday lenders often utilize "coercive techniques to intimidate consumers to collect debts,"[43] in addition to generally harmful and harassing conduct.[44] At the time of the Proposal's release, the CFPB had received approximately 24,000 consumer complaints related to payday loan debt collection practices.[45]

States have prioritized the regulation of payday lending to

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37. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47,873.

38. Martin, *supra* note 33, at 573.

39. Edsall, *supra* note 32.

40. LAUREN SAUNDERS, LEAH PLUNKETT & CAROLYN CARTER, NAT'L CONSUMER L. CTR., STOPPING THE PAYDAY LOAN TRAP: ALTERNATIVES THAT WORK, ONES THAT DON'T 4 (2010), https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf (noting that payday lenders use specialized credit reporting services to track the subprime market).

41. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47,920 (claiming that nearly one in five consumers using payday loans receive some form of public assistance or other benefits as a source of income). One study conducted by the Center for Responsible Lending suggests that the median annual income of a borrower is as low as $22,476. Edsall, *supra* note 32.

42. *See* Martin, *supra* note 33, at 575 (citing a study revealing that as many as 10% of individuals who declared bankruptcy listed taking out more than one payday loan).

43. Hayes, *supra* note 25, at 1143.

44. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47,930.

45. *Id.* at 47,898.

combat these predatory lending practices.[46] Many states set limits on payday loan amounts, ranging from $300 to $1,000.[47] Others limit the amount of a payday loan to the lesser of a percentage of the borrower's income or a fixed dollar amount.[48] Only two states, Nevada and Wyoming, are silent as to the maximum payday loan amount permitted.[49] Some states set a maximum amount for fees, with 15%, or $15 per $100, of the amount borrowed being the most common limit.[50]

Michigan limits transactions to $600 and prohibits payday lending to consumers who already have more than one open transaction with another licensed lender.[51] Fees are capped at 15% on the first $100 borrowed, 14% on the second $100, and eventually decline to 11% on the fifth and sixth $100.[52] Arbitration can be required only if the lender agrees to cover all of the expenses relating to arbitration.[53] In addition, Michigan created a private right of action for any "person injured by a licensee's violation" of its Deferred Presentment Services Transactions

46. For more information on state statutes regulating payday lending, visit *Payday Lending State Statutes*, NAT'L CONF. OF STATE LEGIS. (Sept. 9, 2016), http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx. Georgia even declared that "the site or location of a place of business where payday lending takes place . . . is . . . a public nuisance." GA. CODE ANN. § 16-17-8 (2016).

47. At least nineteen States cap payday loan amounts at $500 or $600 (Alabama, Alaska, Florida, Hawaii, Iowa, Kansas, Kentucky, Michigan, Mississippi, Missouri, Nebraska, North Dakota, Ohio, Oklahoma, Rhode Island, South Carolina, South Dakota, Tennessee, and Virginia), while California limits payday loans to $300, and Delaware caps payday loans at $1,000. *See* ALA. CODE § 5-18A-12(a) (2016); ALASKA STAT. § 06.50.410 (2016); CAL. FIN. CODE § 23035(a) (West 2016); DEL. CODE ANN. tit. 5 § 2227(7) (2016); FLA. STAT. § 560.404(5) (2016); HAW. REV. STAT. § 480F-4(c) (2016); IOWA CODE § 533D.10(1)(b) (2016); KAN. STAT. ANN. § 16a-2-4-4(1)(c) (2016); KY. REV. STAT. ANN. § 286.9-100(9) (West 2016); MICH. COMP. LAWS § 487.2153(1) (2016); MISS. CODE ANN. § 75-67-519(2) (2016); MO. REV. STAT. § 408.500(1) (2016); NEB. REV. STAT. § 45-919(1)(b) (2016); N.D. CENT. CODE § 13-08-12(3) (2016); OHIO REV. CODE ANN. § 1321.39(A) (West 2015); OKLA. STAT. tit. 59 § 3106(7) (2016); R.I. GEN. LAWS § 19-14.4-5.1(a) (2016); S.C. CODE ANN. § 34-39-180(B) (2016); S.D. CODIFIED LAWS § 54-4-66 (2016); TENN. CODE ANN. § 45-17-112(o) (2016); VA. CODE ANN. § 6.2-1816(5)(2016).

48. IDAHO CODE ANN. § 28-46-413(1)–(2) (2016) (limiting a payday loan amount to the lesser of 25% of a borrower's income or $1,000); 815 ILL. COMP. STAT. 122/2-5(e) (2016) (limiting payday loan amount to the lesser of 25% of a borrower's income or $1,000); IND. CODE § 24-4.5-7-402, 404 (2016) (20% or $550); WASH. REV. CODE § 31.45.073(2) (2016) (30% or $700); WIS. STAT. § 138.14(12)(b) (2016) (35% or $1,000).

49. NEV. REV. STAT. § 604A.425(1)(b) (2015); WYO. STAT. ANN. § 40-14-363 (2016).

50. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,869 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041).

51. Jopel Shih, *Payday Lending: A Thin Line Between Love and Hate*, 3 FAULKNER L. REV. 37, 58 (2011).

52. *Id.*

53. *Id.*

Act, which includes a right to recover attorney's fees.[54]

New Mexico once relied on small-loan legislation to regulate payday loans, but the absence of a dedicated payday-lending statute left a void in regulation.[55] Eventually, New Mexico capped payday loan fees at $15.50 per $100 borrowed.[56] Payday lenders must offer an automatic 130-day, no-cost payment plan, as well as limit outstanding loans to 25% of a borrower's gross monthly income.[57]

North Carolina prohibits payday lending.[58] However, online payday lenders based overseas or on Indian reservations continue to make payday loans by taking advantage of a legal principle called Tribal Sovereign Immunity; in referencing this principle, payday lenders claim they are not subject to North Carolina laws, a common practice among payday lenders throughout the U.S.[59] Additionally, payday lenders contract with "federally chartered banks . . . to take advantage of federal banking laws that allow such banks to make loans across state lines without regard to that state's interest [rate limits] in 'rent-a-charter' or 'rent-a-bank' contracts."[60] Despite increased state regulation, the payday loan industry regularly finds and abuses loopholes in almost every state law passed.[61] Overall, the CFPB argues that the Proposal is necessary to adequately protect consumers because state regulations have not been able to substantially reduce rates of

54. MICH. COMP. LAWS § 487.2165 (2016).

55. Shih, *supra* note 51, at 58.

56. Megan Kamerick, *Compromise Reached on Proposed Payday Lending Reforms*, ALBUQUERQUE BUS. FIRST (Feb. 13, 2007, 7:30 PM), http://www.bizjournals.com/albuquerque/stories/2007/02/12/daily15.html.

57. *Id.*

58. *Payday Loans*, N.C. DEPT. OF JUSTICE, http://www.ncdoj.gov/Consumer/Credit-and-Debt/Payday-Loans.aspx (last visited Dec. 20, 2016).

59. *Id.* For more information on payday lenders using Tribal Sovereign Immunity to evade state regulation, see generally Nathalie Martin & Joshua Schwartz, *The Alliance Between Payday Lenders and Tribes: Are Both Tribal Sovereignty and Consumer Protection at Risk?*, 69 WASH. & LEE. L. REV. 751 (2012).

60. Ga. Cash Am., Inc. v. Greene, 318 Ga. App. 355, 359 (2012).

61. *See, e.g.*, Martin, *supra* note 33, at 578–95; Creola Johnson, *America's First Consumer Financial Watchdog is on a Leash: Can the CFPB Use Its Authority to Declare Payday-Loan Practices Unfair, Abusive, and Deceptive?*, 61 CATH. U. L. REV. 381, 399–401 (2012) (noting how payday lenders use Native American tribal immunity to circumvent state regulations); William Isaac, *Why Payday Loans are Good for Millions of People*, AM. BANKER (Aug. 13, 2013), http://www.americanbanker.com/bankthink/why-payday-loans-are-good-for-millions-of-people-1061280-1.html ("Some online lenders avoid regulation by setting up operations offshore or on an Indian reservations outside the reach of regulators.").

reborrowing and effectively protect particularly vulnerable borrowers.[62]

C. Lack of Consumer Understanding

There is mixed data and sentiment with respect to borrowers' understanding of their rights and obligations when taking out payday loans.[63] Critics of payday lending suggest there is a tremendous lack of understanding among borrowers caused by numerous factors, some of which are attributable to payday lenders and others not.[64] Due to this alleged gap in knowledge, borrowers infrequently appreciate the commitment they are entering into when taking out payday loans.[65] For example, borrowers tend to incorrectly believe they will not need to roll over their loan.[66] Unfortunately, borrowers often underestimate the length of time their indebtedness will last.[67] In a 2012 study where borrowers were interviewed at curbside after taking out a payday loan, borrowers consistently misunderstood how the loans were structured.[68] Several borrowers were unaware that paying the minimum fees did not reduce the principal.[69] Furthermore, few respondents could recite the APR on their loans[70] and borrowers had difficulty stating the dollar cost of their loans over time.[71]

In contrast, other studies suggest that payday lenders provide

62. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,931–32 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041) (arguing that state regulatory frameworks have "still left many consumers vulnerable to the specific harms . . . relating to reborrowing, default, and collateral harms from making unaffordable payments").

63. Dennis Shaul, *CFPB Payday Loan Rule Ignores Existing Research*, LAW360 (Sept. 22, 2016), http://www.law360.com/articles/842022/opinion-cfpb-payday-loan-rule-ignores-existing-research.

64. Factors leading to a lack of understanding among borrowers include misleading marketing on how payday loans work, borrowers' perception that no alternative exists, financial distress leading to a lack of searching for alternative options. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47,928.

65. *See* Ronald Mann, *Just Until Payday*, 54 UCLA L. REV. 855, 881–82 (2007) ("[A] person with normal experiences, normal time constraints, and normal intelligence does not easily evaluate the risks and rewards of a payday lending transaction.").

66. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47,928.

67. *Id*.

68. Martin, *supra* note 33, at 599–600.

69. Martin, *supra* note 33, at 600.

70. Martin, *supra* note 33, at 600.

71. Martin, *supra* note 33, at 600.

sufficient information for borrowers to make informed decisions.[72] A 2016 survey conducted by the Global Strategy Group and the Tarrance Group found that as many as 96% of payday loan borrowers said they completely understood how long it would take to repay their payday loan and the fees they would incur.[73] That same survey also suggests that over 90% of borrowers said the lender "clearly explained" both the terms of the loan and the consequences of not repaying the loan on time.[74]

III. THE PROPOSED RULE

The Proposal is one of the most divisive in the history of the CFPB.[75] This Part describes what types of loans are covered under the Proposal.[76] Then, it outlines the ability-to-repay ("ATR") test and what it is designed to address.[77] This Part ends by explaining the circumstances in which the Proposal exempts lenders from conducting an ATR test and other reporting requirements under the Proposal.[78]

A. Loans Covered Under the Proposal

The Proposal applies to two types of loans ("Covered Loans").[79] The first type of Covered Loans are those with terms of over forty-five days, including loans where vehicle title is taken as collateral.[80] This Note focuses on the second type of Covered Loans: those with terms of forty-five days or less, including typical fourteen-day and thirty-day payday loans.[81]

72. GLOB. STRATEGY GRP. & TARRANCE GRP., BORROWER AND VOTER VIEWS OF PAYDAY LOANS 18 (2016), http://www.tarrance.com/docs/CFSA-BorrowerandVoterSurvey-AnalysisF03.03.16.pdf.

73. *Id.* at 6.

74. *Id.*

75. *See As the Comment Period Comes to a Close, Legislators Diverge on Payday Lending*, PYMNTS (Oct. 4, 2016), http://www.pymnts.com/news/alternative-financial-services/2016/as-the-comment-period-comes-to-a-close-legislators-diverge-on-payday-lending/.

76. *See infra* Part III.A.

77. *See infra* Part III.B.

78. *See infra* Part III.C.

79. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,911 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041).

80. *Id*. at 47,912.

81. *Id*. at 47,869. The Proposal does not apply to (1) purchase money security interest

B. *The Ability-to-Repay Test*

The Proposal declares it an "abusive and unfair practice" for a lender to make a covered loan without reasonably determining that the borrower can repay the loan while also paying for certain living expenses.[82] The Proposal requires a lender to conduct an ATR test prior to making a covered loan.[83] In conducting an ATR test, a lender must make a reasonable determination that the potential borrower would be able to repay the loan on time while also meeting his other "major financial obligations" and "basic living expenses."[84] A lender must determine that the borrower will be able to cover his basic living expenses without needing to extend the loan or take out another loan within the thirty days following the initial payday loan.[85] The lender must conduct an ATR test using the borrower's income, any other outstanding debt obligations, and living expenses.[86]

In conducting an ATR test, a lender must: (1) verify the consumer's net income; (2) verify the consumer's debt obligations using two different consumer reporting systems; (3) verify the consumer's housing costs or use a reliable method of estimating a consumer's housing expense; (4) forecast a reasonable amount of basic living expenses necessary for a consumer to maintain the consumer's health, welfare, and ability to produce income; (5) project the consumer's net income, debt obligations, and housing costs for a period of time based on the term of the loan; and (6) determine the consumer's ability to repay the loan based on the lender's projections of the consumer's income, debt obligations, and housing costs and forecast of basic living expenses for the consumer.[87]

One of the Proposal's priorities is to combat the debt cycle

loans extended solely to finance the purchase of a car or other consumer good where the good secures the loan; (2) home mortgages and other loans secured by real property; (3) credit cards; (4) student loans; (5) non-recourse pawn loans; and (6) overdraft services and lines of credit. *Id.* at 47,917. Although these products have the potential to lead to harmful consequences similar to those of payday lending, these types of loans arise in distinct markets that the CFPB believes may pose a different set of concerns for borrowers. *Id.*

82. *Id*. at 47,864–65.

83. *Id*. at 47,865.

84. *Id*.

85. *Id*.

86. *Id*.

87. *Id*.

borrowers often fall into.[88] The CFPB refers to this debt cycle as "sustained use,"[89] which is the long-term or repeated use of short-term, high-cost products.[90] This may become harmful when borrowers utilize these products to cover continuous cash flow shortages,[91] forcing borrowers to incur fees that eventually exceed the principal.[92] A pattern of sustained use may indicate that a borrower is unable to repay the principal while also meeting his other basic living expenses.[93] The ATR test aims to ensure that borrowers, when taking out payday loans, can repay loans on time while covering these necessities.[94]

Studies and surveys shed light on sustained use and the debt trap into which borrowers often fall into.[95] A 2013 CFPB study surveying a twelve-month period found that the median number of transactions per payday borrower was ten, and borrowers were indebted for a median of 199 days.[96] A 2009 survey conducted by the CRL found that as little as 2% of payday loan volume stems from non-repeat borrowers, and over 80% of payday borrowers take out multiple payday loans per year.[97] Further, a 2004 study conducted by the CRL found that payday lenders make 91% of payday loans to borrowers who take out at least five loans per year.[98]

The ATR test, by ensuring that borrowers will be better able to

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88. CONSUMER FIN. PROT. BUREAU, *supra* note 7, at 4.

89. *Id.*

90. *Id.*; *see also id.* at 43 (noting that a "sizeable" share of borrowers conduct many short-term transactions over a long period of time).

91. *Id.*

92. *Id.* at 4.

93. *Id.* at 24.

94. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,936 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041) (addressing how the ATR test can help avoid many injuries borrowers face, one of which is the inability to cover basic living expenses while repaying the loan on time).

95. Martin, *supra* note 33, at 573.

96. CONSUMER FIN. PROT. BUREAU, *supra* note 7, at 23.

97. LESLIE PARRISH & URIAH KING, CTR. FOR RESPONSIBLE LENDING, PHANTOM DEMAND: SHORT-TERM DUE DATE GENERATES NEED FOR REPEAT PAYDAY LOANS, ACCOUNTING FOR 76% OF TOTAL VOLUME 2–3 (2009), http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf; *see also* Martin, *supra* note 33, at 573 (noting how empirical studies report that repeat customers comprise "the vast majority" of all payday lending customers).

98. KEITH ERNST, JOHN FARRIS & URIAH KING, CTR. FOR RESPONSIBLE LENDING, QUANTIFYING THE ECONOMIC COST OF PREDATORY PAYDAY LENDING 7 (2004), http://www.responsiblelending.org/payday-lending/research-analysis/CRLpaydaylendingstudy121803.pdf.

repay their loans on time, theoretically eliminates, or at least curbs, the predatory debt collection practices payday lenders or third-party debt collectors often employ.[99] Collection activities include calls, letters, and visits to borrowers' homes and workplaces.[100] Many payday lenders pursue judicial action as well.[101] Moreover, some lenders turn to illegal debt collection practices, such as false threats to add new fees, deceptive messages to induce borrowers to return calls, and fallacious referrals to a non-existent in-house collections department.[102] These practices can cause psychological distress and anxiety in borrowers who are already under financial pressure.[103] The Proposal addresses these exploitative techniques through the ATR test, which would reduce borrowers rolling over loans, reduce default rates, and thus, reduce the need for lenders to collect.[104]

C. Principal Payoff Option for Certain Short-Term Loans

The principal payoff option allows a lender, without conducting an ATR test, to make a covered loan up to $500 if the loan does not include a security interest in a vehicle.[105] The principal payoff option is designed for lower-risk lending situations.[106] The lender may extend the loan twice, but only if the principal is reduced by one-third each time.[107] However, a lender may not make a covered loan if it would result in the borrower either having more than six outstanding covered

99. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47,874 (outlining various collection methods lenders employ upon default).

100. CFPB COMPLIANCE BULLETIN 2015-2017, IN-PERSON COLLECTION OF CONSUMER DEBT, CONSUMER FIN. PROT. BUREAU (Dec. 16, 2015), https://files.consumerfinance.gov/f/201512_cfpb_compliance-bulletin-in-person-collection-of-consumer-debt.pdf.

101. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47,874 ("A study of small claims court cases filed in Utah from 2005 to 2010 found that 38% of cases were attributable to payday loans.").

102. CONSUMER FIN. PROT. BUREAU, SUPERVISORY HIGHLIGHTS 17–19 (Spring 2014), http://files.consumerfinance.gov/f/201405_cfpb_supervisory-highlights-spring-2014.pdf.

103. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47,930.

104. *See id.* at 47,865 (describing the primary and secondary impacts of the ATR test).

105. *Id.*

106. *CFPB Fact Sheet: Payday Debt Traps (Payday, auto-title, and similar credit)*, NAT'L ASS'N OF STATE CREDIT UNION SUPERVISORS (2016), http://nascus.org/regulatory-resources/CFPB%20Fact%20Sheet%20Payday%20Debt%20Traps%206-28-16.php.

107. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. at 47,930.

loans during a consecutive twelve-month period or being in debt for more than ninety days during that same period.[108]

The principal payoff option includes a number of screening and structural protections for consumers receiving loans not covered under the Proposal.[109] These protections reduce the likelihood and magnitude of consumer harm from defaulting on and extending payday loans.[110] The exception would allow a consumer with occasional shortfalls in income to receive a limited number of covered loans.[111]

D. Registered Information Systems and Monitoring

The Proposal also requires lenders to disseminate basic information for covered loans to registered information systems regarding origination, any updates to that information over the life of the loan, and certain information when the borrower repays the loan in full.[112] According to the CFPB, the registered information systems would provide a "reasonably comprehensive record" of a borrower's recent and current borrowing.[113] Over time, this registered information system will alleviate some of the burden on the lender in determining whether a consumer passes the ATR test.[114]

Lenders are also required to establish and follow a compliance program and retain certain additional records.[115] Lenders must also develop and follow certain written policies designed to ensure compliance with the Proposal.[116] Lenders would be responsible for retaining the loan agreement, documentation obtained for a covered loan, and electronic records including origination calculations and determinations for a covered loan for a borrower who passes the ATR test.[117]

108. *Id.*
109. *Id.* at 47,969.
110. *Id.* at 47,865.
111. *Id.* at 47,970.
112. *Id.* at 47,866.
113. *Id.*
114. *See id.* (discussing how registered information systems "would provide a reasonably comprehensive record" of a consumer's borrowing habits).
115. *Id.*
116. *Id.*
117. *Id.*

IV. ANALYSIS OF THE PROPOSED RULE

This Part analyzes the Proposal and critiques it in light of its goals. First, Section A outlines concerns over the breadth of the Proposal and the potential for reduced access to credit, as well as available alternatives to payday loans.[118] Second, Section B describes mixed consumer sentiment towards payday lending and whether consumers truly desire payday lending reform.[119]

A. Breadth of the Proposal and Reduced Consumer Access to Credit

Payday lenders furnish a valuable service by providing credit, and therefore short-term relief, to borrowers often in their most desperate time of need.[120] Borrowers who do not qualify for other credit products praise the availability of payday loans,[121] and often report having no alternative source of credit when taking out a payday loan.[122] One survey suggests over nine in ten borrowers agree that payday loans can be a sensible decision for consumers who are faced with unexpected expenses.[123]

Payday lenders fear that the "extremely complex and prescriptive nature" of the voluminous 1,300-page Proposal will regulate them out of the market.[124] Consumers will face reduced access to credit if droves of payday lenders exit the marketplace.[125] The CFPB is sensitive to these concerns and recognizes the need for emergency

118. *See infra* Part IV.A.

119. *See infra* Part IV.B.

120. CTR. FOR RESPONSIBLE LENDING, PAYDAY LOANS PUT FAMILIES IN THE RED (2009), http://www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf.

121. CONSUMER FIN. PROT. BUREAU, *supra* note 7, at 3.

122. GLOB. STRATEGY GRP. & TARRANCE GRP., *supra* note 72, at 18 (noting that almost 75% of borrowers who took out a payday had no alternative access to credit).

123. GLOB. STRATEGY GRP. & TARRANCE GRP., *supra* note 72, at 17.

124. Comment Letter from Camden Fine, Pres. & CEO, Indep. Cmty. Bankers of Am., & Jim Nussle, Pres. & CEO, Credit Union Nat'l Ass'n, to Richard Cordray, Dir., Consumer Fin. Prot. Bureau (June 27, 2016), https://www.cfpbmonitor.com/wp-content/uploads/sites/5/2016/06/ICBA-Letter.pdf.

125. Press Release, Consumer Fin. Prot. Bureau, CFPB Examines Payday Lending (Jan. 19, 2012, 7:50 PM), http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-examines-payday-lending/; Fine & Nussle, *supra* note 124.

credit,[126] but if the Proposal is adopted, many lenders, including community banks and credit unions, may eliminate existing products or refrain from developing new borrower-friendly, short-term loan options.[127]

The Proposal will impact different lenders in different ways. For example, community banks and other smaller lenders operate differently from larger institutions.[128] Most community banks are locally owned and have strong ties to their surrounding communities.[129] Regulatory compliance requirements will impose a disproportionate burden on community banks and smaller lenders relative to larger institutions, which have dedicated legal resources, larger compliance staffs, and can shift the costs of compliance across a larger number of loans.[130] A heavier compliance burden places smaller lenders at a competitive disadvantage and may lead to reduced consumer access to credit if these lenders, as a response to being disadvantaged, exit the marketplace.[131]

Reduced access to credit as a result of the Proposal may cause consumers to borrow from alternative sources less beneficial than payday loans, including offshore payday lenders, whom the CFPB has already targeted.[132] Supporters of payday lending argue that a payday loan may be better than no credit at all.[133] However, opponents of payday lending contend that the risk of borrowers turning to less reputable or beneficial providers of credit is insufficient to justify allowing current practices in the payday lending industry to continue.[134]

Weakening the argument of the payday lending community is that there are numerous alternatives for borrowers even if the Proposal

126. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,920 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041).

127. Fine & Nussle, *supra* note 124.

128. *See* Comment Letter from Viveca Ware, Exec. Vice Pres. Reg. Pol'y, Indep. Cmty. Bankers of Am., to David Silberman, Assoc. Dir. for Research, Markets, and Regulations, Consumer Fin. Prot. Bureau 8 (Oct. 6, 2015), https://www.regulations.gov/document?D=CFPB-2016-0025-0033 (discussing how the Proposal impacts lenders with different operations).

129. *Id.* at 1.

130. *Id.* at 8.

131. Id.

132. Mann, *supra* note 65, at 886.

133. Richard Hynes, *Payday Lending, Bankruptcy, and Insolvency*, 69 WASH. & LEE L. REV. 607, 610 (2012).

134. Mann, *supra* note 65, at 887–88.

regulates some lenders out of the marketplace.[135] For example, credit card cash advances are less expensive than payday loans, typically offering an APR of 30%.[136] Small consumer-finance companies offer small short-term loans with a cost up to 60% APR, but are usually in the range of 25 to 36%.[137] These loans allow a consumer to borrow $1000 for a year at an overall lower cost than a $300 payday loan over the same period.[138] Many employers advance paychecks—a process which has no interest at all[139]—where an employee repays the advance out of his next paycheck.[140] Additionally, banks could fill any gap in consumer access to credit the Proposal leaves behind.[141] Notwithstanding the availability of numerous lower cost alternatives to payday loans, one issue remains: scores of borrowers simply do not qualify or choose not to utilize these alternative products, adding strength to payday lenders' arguments with respect to the Proposal's potentially devastating impact on reduced consumer access to credit.[142]

B. Consumer Satisfaction with the Payday Lending Industry

Studies reveal mixed attitudes among consumers with respect to the payday lending industry.[143] The CFPB gathered the information

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135. Hayes, *supra* note 25, at 1158 (noting how banks and credit unions provide lower cost alternatives to payday loans). *But see* Hayes, *supra* note 25, at 1158 ("[B]anks and credit unions have traditionally shied away from payday lending.").

136. *Alternatives to Payday Loans*, PINE TREE LEGAL ASSISTANCE (Sept. 2014), http://ptla.org/alternatives-payday-loans.

137. Brendan Case, *With Payday Loans, Poor Get the Loans, Firms Get the Payday*, DALLAS NEWS: MONEY (July 2010), http://www.dallasnews.com/business/money/2010/07/26/with-payday-loans-poor-get-the-loans-firms-get-the-payday.

138. *Id.*

139. *Id.*

140. Dana Dratch, *How Employee Salary Advances Work* (Jul. 17, 2013), http://www.creditcards.com/credit-card-news/employee-salary-pay-advance-1273.php.

141. Hayes, *supra* note 25, at 1158.

142. *See* Martin, *supra* note 33, at 618–19 (claiming borrowers do not use alternatives to payday loans out of embarrassment).

143. *E.g.*, U. OF N.C. CTR. FOR CMTY. CAPITAL, NORTH CAROLINA CONSUMER AFTER PAYDAY LENDING: ATTITUDES AND EXPERIENCES WITH CREDIT OPTIONS 12 (2007), http://www.nccob.gov/public/docs/News/Press%20Releases/Archives/2007/NC_After_Payday.pdf (finding "stark" differences in attitudes towards payday lending). Some payday loan users praise the speed at which they could acquire money, yet others feel payday lenders take advantage of desperate borrowers. *Id.* Borrowers highlighted the benefit of using payday loans for "extra money between paychecks," yet others reported they took out a payday loan and eventually "go[t] into more debt." *Id.*

underlying the Proposal from numerous sources, including consumer complaints.[144] As of January 1, 2016, the CFPB had received approximately 36,200 consumer complaints relating to payday loans.[145] Specific complaints include payday lenders' behavior causing psychological and emotional distress due to numerous phone calls, threats of legal action, and repeated contacts with borrowers' family members and employers.[146] Additional complaints include payday lenders initiating payments before the due date on loans and triggering bank fees by attempting to withdraw more than the scheduled amount.[147]

Despite the list of borrowers' complaints, it is unclear whether consumer sentiment is as opposed to payday lending practices as the CFPB suggests.[148] In July 2011, the CFPB launched a complaint portal where consumers could voice their frustrations about financial firms.[149] After filing a Freedom of Information Act request, the Community Financial Services Association of America ("CFSA"), a trade association representing the short-term lending industry, claimed that 12,308 of the 12,546 comments submitted "praised the industry . . . or otherwise indicated positive experiences."[150] The CFSA argues that more than 98% of comments submitted on short-term loans praised the industry for its products and services.[151] Further, the CFSA claimed the "vast majority" of the 238 comments indicating negative experiences were either mistakenly categorized as payday lending comments or related to scams and unregulated lenders that the Proposal fails to address.[152]

The discrepancy between the apparent high level of satisfaction

144. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,867 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041).

145. *Id.* at 47,898.

146. *Id.* at 47,991.

147. *Id.* at 48,050.

148. *See* GLOB. STRATEGY GRP. & TARRANCE GRP., *supra* note 72, at 29 (suggesting that borrowers are generally supportive of payday lending).

149. Yuka Hayashi, *Consumers With Complaints Flock to CFPB*, WALL ST. J. (July 25, 2016), http://www.wsj.com/articles/cfpb-complaints-center-generates-results-and-controversy-1469439003?mg=id-wsj.

150. *CFPB Buried, Ignored Positive Payday Loan Customer "Tell Your Story" Testimonials it Requested*, CMTY. FIN. SERV. ASS'N OF AM. (Sept. 6, 2016), http://cfsaa.com/our-resources/communications/recent-news/article-detail/newsid/131.aspx.

151. *Id.*

152. *Id.*

among borrowers and the state of affairs suggested in the Proposal has led some to question whether consumers truly desire more strict regulation of payday loans.[153] Perhaps the high rate of borrower satisfaction in some surveys suggests that most payday lenders provide quality service, and only a few payday lenders are causing the harmful results that the Proposal seeks to eliminate.[154]

V. INCENTIVIZING BANKS TO ENTER THE MARKETPLACE

Banks entering the payday/high-risk short-term loan marketplace could mitigate concerns over the Proposal reducing consumer access to credit. Additionally, banks could potentially replace payday lenders altogether, reducing instances of aggressive, harmful debt collection practices and other predatory lending activities often associated with payday lenders. As it stands now, the Proposal does little to incentivize banks to enter the marketplace.

Part V suggests modifications to the Proposal that will incentivize banks to enter the payday lending marketplace and also calls for federal regulators to encourage and provide support to banks willing to provide short-term credit products to consumers. Section A discusses why banks are in a good position to extend payday loans.[155] Next, Section B explains why banks are hesitant to enter the marketplace and suggests that these concerns may be unjustified.[156] Section C then demonstrates how increasing the number of safe harbors that would permit institutions to avoid conducting ATR tests reduces banks' concerns and encourages banks to enter the marketplace, using one safe harbor based off of the Qualified Mortgage principal in Sections 1411 and 1412 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") as a model.[157]

153. *Id.*

154. *See* GLOB. STRATEGY GRP. & TARRANCE GRP., *supra* note 72, at 6 ("The vast majority of borrowers say the lender clearly explained the terms of the loan . . . . [B]orrowers say . . . that payday lenders are flexible when working with borrowers who experience payment difficulties.").

155. *See infra* Part V.A.

156. *See infra* Part V.B.

157. *See infra* Part V.C; *see also* Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") §§ 1411–12, 15 U.S.C. § 1639c (2012) (listing the requirements of a qualified mortgage).

A. *Banks are Well-Positioned to Make Payday Loans*

Banks can recapture the entire payday lending marketplace if they offer alternative products and services with better terms than payday loans.[158] Generally, banks can offer a different mix of products to low-income borrowers and already have an established infrastructure and staff.[159] Banks can spread the risk of loss over all their products[160] and do not have to rely exclusively on payday loan revenues to operate.[161] In addition, banks have greater access to capital to finance loans.[162] Whether or not the Proposal is finalized, by competing with payday lenders at lower prices, banks could force payday lenders to adopt better terms or potentially exit the marketplace.[163]

Banks possess a number of tools to compete with payday lenders.[164] One such tool is overdraft protection charges.[165] Banks can structure overdraft charges in a way that allows borrowers to repay such charges easily, similar to a payment plan.[166] Products could provide a borrower multiple pay periods through which they can accumulate sufficient funds to repay the loan or allow a borrower to repay the loan through installments over a few weeks or months.[167] Unlike payday lenders, banks could choose to allow partial payments, and borrowers would be able to build credit because banks could report those payments to credit agencies.[168] Banks may be able to undercut payday lenders

158. Michael Bertics, *Fixing Payday Lending: The Potential of Greater Bank Involvement*, 9 N.C. BANKING INST. 133, 150 (2005).

159. Kenneth, *supra* note 19, at 708. *But see id.* ("But to become a convenient option, banks may need to open more locations and potentially keep longer hours.").

160. SHEILA BAIR, ANNIE E. CASEY FOUND., LOW-COST PAYDAY LOANS: OPPORTUNITIES AND OBSTACLES 3 (2005), https://folio.iupui.edu/bitstream/handle/10244/101/FEs3622H334.pdf?sequence=1.

161. Kelly Noyes, *Get Cash Until Payday! The Payday-Loan Problem in Wisconsin*, 2006 WIS. L. REV. 1627, 1675 (2006).

162. *Id.* at 1674.

163. *See* Bertics, *supra* note 158, at 149–50 (arguing that customers would likely deal with minor inconveniences, such as traveling longer distances and dealing with less extensive hours, to take advantage of lower rates and better terms offered by banks, which would allow banks to gain access to a larger customer base).

164. Kenneth, *supra* note 19, at 700.

165. Kenneth, *supra* note 19, at 700.

166. Kenneth, *supra* note 19, at 700.

167. Kenneth, *supra* note 19, at 709.

168. Kenneth, *supra* note 19, at 709.

through limits on APRs.[169] Finally, even if banks could not offer lower fees per loan, banks could still meet structural standards for loans that payday lenders could not, providing borrowers with increased flexibility.[170]

B. Banks are Hesitant to Enter the Marketplace

Although banks are well-positioned to make payday loans, many are hesitant to, or simply do not, make payday loans for numerous reasons.[171] Three common reasons for banks' hesitancy to enter the payday lending marketplace include reputational concerns, the profitability of payday loans, and regulatory animosity toward federally regulated banks offering payday loans.

A bank's reputation is undeniably important,[172] and banks are concerned with the reputational risk associated with payday lending.[173] Companies and firms find it profitable to develop a reputation for honesty and integrity,[174] and making payday loans may tarnish a bank's image in the community.[175] While the emphasis on maintaining a positive reputation is well-founded, the reputational risk of payday lending may not be as prevalent if there is an effective regulation scheme governing the practice.[176] Jonathan Macey, in an article on the reputational model in capital markets, argues the following:

> [T]he value to financial institutions of investing in reputation declines to the extent that a regulatory system that people believe is effective is put into place. This is because reputation and regulation, both of which serve

169. Kenneth, *supra* note 19, at 708.
170. Kenneth, *supra* note 19, at 709.
171. BAIR, *supra* note 160, at 9.
172. *E.g.*, Woodward v. Raymond James Fin., Inc., 732 F. Supp. 2d 425, 434 (S.D.N.Y. 2010).
173. Michelle Leder, *How the Other Half Banks: The Depressing, Amazing "Payday Loan" Business*, SLATE (May 10, 2004), http://www.slate.com/articles/business/moneybox/2004/05/how_the_other_half_banks.html.
174. Jonathan Macey, *The Demise of the Reputational Model in Capital Markets: The Problem of the "Last Period Parasites"*, 60 SYRACUSE L. REV. 427, 430–31 (2010).
175. BAIR, *supra* note 160, at 9.
176. *See* Macey, *supra* note 174, at 445 (arguing that reputation and an effective regulation scheme are direct substitutes).

> the role of providing contracting parties with some reassurance that they won't be cheated or taken advantage of in the course of financial dealings, are substitutes for one another.[177]

Using Macey's theory, a Proposal that adequately regulates payday lending could theoretically ease one of banks' primary concerns by eliminating, or at least drastically reducing, the potential reputational harm payday lending poses to banks.

Even if the Proposal is not adopted and there is no regulation scheme to substitute for reputation, banks can still protect their reputations if they enter the marketplace. Much of the animosity toward payday lending stems from the allegedly abusive behavior of payday lenders.[178] Thus, banks can mitigate the risk of reputational harm by responsibly providing products similar to payday loans without engaging in abusive practices. Further, banks have economic incentives to avoid engaging in reputation-harming practices, such as aggressive debt collection and predatory lending.[179] Developing a positive reputation is costly and time-consuming, and harming one's reputation results in losing business and increased transaction costs.[180] If more banks enter the payday lending marketplace and transform the market into a competitive one, banks will be motivated to achieve profitability and the value of their companies will increase by developing and maintaining a positive reputation.[181]

A second chief concern of banks revolves around the higher risks of payday lending, which involves risky products requiring high interest rates in order to maintain profitability.[182] Banks are concerned with the profitability of payday lending even in the absence of the Proposal,[183] and the Proposal only further increases the costs and

177. Macey, *supra* note 174, at 445.

178. *See* Shih, *supra* note 51, at 40 (arguing that opponents of payday lending focus not on the actual products, but on consumers who are "fooled into credit arrangements they cannot understand").

179. Macey, *supra* note 174, at 447–48.

180. Macey, *supra* note 174, at 448.

181. *See* Bryson Kern, *Reputational Injury Without a Reputational Attack: Addressing Negligence Claims for Pure Reputational Harm*, 83 FORDHAM L. REV. 253, 256 (2014) (outlining how damaging a firm's reputation places the firm's economic security at risk).

182. BAIR, *supra* note 160, at 9.

183. Kenneth, *supra* note 19, at 694.

threatens the profitability of payday lending.[184] In response to these concerns, the CFPB argues that it has designed the ATR test requirement to minimize significant and unnecessary costs.[185] Specifically, the CFPB believes that the ATR test will significantly offset compliance costs because the ATR test will reduce the rate of default, and as a result, reduce expenses associated with defaulting borrowers.[186]

Reducing costs of compliance with the Proposal addresses one of banks' primary concerns: maintaining profitability with a risky product like payday lending. To reduce compliance costs, the payday lending industry is advocating for, among other things, increased flexibility in reporting requirements.[187] As the Proposal currently stands, lenders must meet the same reporting and verification requirements for each borrower.[188] Flexible reporting requirements would enable banks to meet the specific needs of individual borrowers.[189] Since there are a multitude of methods for conducting an ATR test, flexible reporting and verification requirements would enable banks to find the most cost effective and time efficient methods to ensure compliance with the Proposal.[190] However, the CFPB argues that the Proposal already provides for sufficient flexibility; for example, the Proposal aims to provide "substantial flexibility" for the type of evidence lenders can use for verification of income and expenses.[191] Specifically, lenders may use housing estimates instead of obtaining verification evidence.[192] Additionally, the Proposal does not require

184. *See* MAYER BROWN LLP, THE CFPB'S PAYDAY PROPOSAL: BRODER THAN ONE MAY THINK (June 24, 2016), https://www.mayerbrown.com/files/Publication/117ad022-b536-42f6-89c7-38a8863180aa/Presentation/PublicationAttachment/40e512d9-872d-4a79-9cdd-430ce6c6f948/160624-UPDATE-CFS.pdf (outlining the various measures payday lenders must take in complying with the proposal).

185. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 48,001 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041).

186. *Id.*

187. *See* Ware, *supra* note 128, at 9 (discussing how the Proposal impacts lenders with different operations).

188. Ware, *supra* note 128, at 9.

189. Ware, *supra* note 128, at 10.

190. Ware, *supra* note 128, at 1 (knowing a borrower's history and general ability to repay loans gives a lender inside information that other lenders may not possess about their customers).

191. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 48,001 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041).

192. *Id.*

actual verification of basic living expenses.[193] While this flexibility is a step in the right direction, it is clearly insufficient to eliminate banks' concerns over maintaining profitability.[194]

Banks have successfully implemented products similar to payday loans, which may suggest that banks' fear over profitability may be unreasonably high. In 2005, Austin Bank of Chicago first offered Ready Cash Now, a fixed loan ranging from $300 to $999.99 with an APR of almost 12%.[195] The loan is repaid over twelve months through automatic deductions from the borrower's deposit account.[196] The use of lines of credit similar to the one offered by Austin Bank of Chicago decreases servicing costs because banks do not need to assign employees to help borrowers renew loans every two weeks like payday lenders do with roll-over transactions.[197]

La Salle Bank in Chicago developed a small loan product only available for emergency situations.[198] The amount of the loan cannot exceed $1,000, has an APR of 12%, and a maximum term of twelve months.[199] LaSalle has since been purchased by Bank of America,[200] and the fate of its short-term loan program is unknown. Both the LaSalle Bank and Austin Bank of Chicago products had built in protections to deter risky lending, including verifying a borrower's employment history, limiting the maximum debt-to-income ratio allowed, and prohibiting the extension of loans to borrowers currently in bankruptcy.[201]

Citibank's Checking Plus is a revolving line of credit linked to a borrower's bank account.[202] The interest rate is 17%, with the balance repaid in monthly installments through automatic deductions.[203] The default repayment schedule is 1/60th of the outstanding balance, and

193. *Id*.
194. *See* Ware, *supra* note 128, at 9 (expressing concern over the cost of compliance).
195. BAIR, *supra* note 160, at 25.
196. BAIR, *supra* note 160, at 25.
197. Bertics, *supra* note 158, at 153–54.
198. BAIR, *supra* note 160, at 25.
199. BAIR, *supra* note 160, at 25.
200. *Bank of America Completes Purchase of LaSalle Bank*, BANK OF AM., http://investor.bankofamerica.com/phoenix.zhtml?c=71595&p=irol-newsArticle&ID=1057174#fbid=ovw64mXj0tR (last visited Dec. 18, 2016).
201. BAIR, *supra* note 160, at 25–26.
202. BAIR, *supra* note 160, at 27.
203. BAIR, *supra* note 160, at 27.

borrowers can prepay the balances or request a different default repayment schedule.[204]

The North Carolina State Employees' Credit Union ("NCSECU"), in 2001, created the salary-advance loan ("SALO"), a revolving loan with a maximum amount of $500 with an interest rate of 12% that is due on the borrower's next payday.[205] To obtain a SALO, a borrower must place 5% of each advance in a savings account in order to help prevent future borrowing.[206] The SALO program was successful, and the mandatory savings requirement generated $10 million in new deposit funds.[207] NCSECU members rely heavily on SALO loans, suggesting that the product has replaced payday loans in the area.[208] In general, with more incentives and encouragement from federal agencies and regulators, banks are more likely to develop similar products to those outlined above and replace payday lenders, eliminate predatory lending, and provide at-risk borrowers with access to safer alternatives.[209]

A final concern of banks is the perceived regulatory animosity toward partnerships between federally regulated banks and payday lenders.[210] According to the payday lending industry, banks are ending relationships with payday lenders or ceasing to offer certain short-term loan products as a result of increased pressure from agencies such as the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), and the Federal Reserve.[211] For example, in 2014, Wells Fargo & Co., U.S. Bancorp, and Fifth Third Bancorp, due to regulatory pressure, stopped providing short-term products designed as alternatives to payday loans.[212]

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204. BAIR, *supra* note 160, at 27.

205. BAIR, *supra* note 160, at 53.

206. BAIR, *supra* note 160, at 53.

207. Noyes, *supra* note 161, at 1677.

208. Noyes, *supra* note 161, at 1677.

209. *See* Adam Levitin, *Hydraulic Regulation: Regulating Credit Markets Upstream*, 26 YALE J. ON REG. 143, 147 (2009) (noting how proper incentives can provide banks with "stronger incentives to engage in careful and prudent underwriting and to avoid abusive terms likely to trigger defaults and make consumer debt more volatile").

210. *Id*.

211. Annamaria Andriotis & Telis Demos, *Federal Bank Watchdogs Say They're Not Forcing Banks from Payday*, WALL ST. J. (Dec. 8, 2016), http://blogs.wsj.com/moneybeat/2016/12/08/federal-bank-watchdogs-say-theyre-not-forcing-banks-from-payday/?mg=id-wsj.

212. Andrew Johnson & Alan Zibel, *Major Banks Eliminate Short-Term Loans Amid*

Regulatory scrutiny may no longer be a significant concern in the Trump administration, as President Trump will likely seek widespread cuts in regulations across the banking industry.[213] Specifically, Trump is targeting both the CFPB and the Proposal,[214] On January 30, 2017, Trump signed an executive order requiring federal agencies to cut two existing regulations for every new regulation implemented, and also stated that his administration aims to cut regulations "massively" for large and small businesses.[215] On February 3, 2017, Trump signed a memorandum ordering a review of Dodd-Frank with the aim of "cutting a lot out" of those rules.[216] Congressional Republicans have several means of stopping the Proposal from ever being finalized.[217] Republicans could disapprove the Proposal through the Congressional Review Act, or if CFPB Director Cordray steps down, a Trump appointee could simply refuse to finalize the Proposal.[218] However, even if the Proposal is not finalized, banks could still enter the marketplace and service this important consumer need at a lower cost than payday lenders.[219]

C. Expanding the Safe Harbors Available Under the Proposal

The Proposal contains one safe harbor that permits entities to avoid conducting ATR tests: the principal payoff option.[220] The CFPB

Regulatory Scrutiny, WALL ST. J. (Jan. 17, 2014), http://www.wsj.com/articles/SB10001424052702303465004579326353453941082?mg=id-wsj.

213. Michael Corkery, *Trump Expected to Seek Deep Cuts in Business Regulations*, NY TIMES: DEALBOOK (Nov. 9, 2016), http://www.nytimes.com/2016/11/10/business/dealbook/trump-expected-to-seek-deep-cuts-in-business-regulations.html?_r=0.

214. Lucinda Shen, *Donald Trump is Targeting an Agency That Has Recovered $11.8 Billion for Consumers*, FORTUNE: FINANCE (Jan. 27, 2017), http://fortune.com/2017/01/27/donald-trump-cfpb-consumer-protection-financial-bureau-elizabeth-warren/.

215. Bourree Lam, *Trump's 'Two-for-One' Regulation Executive Order*, ATLANTIC (Jan. 30, 2017), https://www.theatlantic.com/business/archive/2017/01/trumps-regulation-eo/515007/.

216. Telis Demos & Peter Rudegeair, *The $100 Billion Reason Investors Loved Trump's Bank Order*, WALL ST. J (Feb. 5, 2017), https://www.wsj.com/articles/the-100-billion-reason-investors-loved-trumps-bank-order-1486321893.

217. Joseph Lawler, *Trump May Be a Boon for Payday Lenders*, WASH. EXAMINER (Nov. 20, 2016, 12:01 AM), http://www.washingtonexaminer.com/trump-presidency-may-be-a-boon-for-payday-lenders/article/2607815.

218. *Id.*

219. Noyes, *supra* note 161, at 1674–75.

220. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,970 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041).

argues that not requiring lenders to conduct ATR tests for loans under the principal payoff option will reduce much of the costs of compliance.[221] However, the CFPB also claims that a "substantial fraction of loans currently made would not qualify for the exemption."[222] Significantly reducing compliance costs while exempting only a minimal number of loans under the principal payoff option are incongruous goals. Additional safe harbors are needed to adequately reduce compliance costs and incentivize banks to enter the marketplace. However, consumer advocates argue that creating additional safe harbors for conducting ATR tests weakens the overall rule framework.[223]

Expanding on the exemptions for conducting ATR tests would enable banks to offer products similar to payday loans without incurring the costs of complying with the Proposal. This would directly address banks' concerns over the profitability of payday lending. One safe harbor for payday loans could be designed using the existing qualifications the CFPB provides for Qualified Mortgages ("QM") under Dodd-Frank.[224] Dodd-Frank permits a lender to extend a QM without conducting an ATR test, as borrowers of a QM are presumed to have the ability to repay the loan.[225] In general, a QM is a mortgage where: (1) points and fees are less than or equal to 3% of the principal; (2) there are no risky features such as negative amortization, interest-only, or balloon loans; and (3) the maximum loan term is less than or equal to thirty years.[226]

On the other hand, if a mortgage does not qualify as a QM, Dodd-Frank requires lenders to make a reasonable, good faith determination that the consumer has a reasonable ability to repay the loan.[227] A lender must consider eight factors when conducting an

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221. *Id.*

222. *Id.*

223. *Id.*

224. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") § 1412, 15 U.S.C. § 1639c (2015) (listing the requirements of a qualified mortgage).

225. *Id.*

226. Dodd-Frank § 1411, 15 U.S.C. § 1639c(b)(2); *Basic Guide for Lenders: What is a Qualified Mortgage?*, CONSUMER FIN. PROT. BUREAU, http://files.consumerfinance.gov/f/201310_cfpb_qm-guide-for-lenders.pdf, (last visited Jan. 5, 2017).

227. CONSUMER FIN PROT. BUREAU, ABILITY-TO-REPAY AND QUALIFIED MORTGAGE RULE: SMALL ENTITY COMPLIANCE GUIDE 17–18 (2014), http://files.consumerfinance.gov/f/201411_cfpb_atr-qm_small-entity-compliance-guide.pdf.

ability-to-repay test for a non-QM under Dodd-Frank: (1) current or reasonably expected income or assets the consumer will rely upon to repay the loan; (2) current employment status; (3) monthly mortgage payment for the loan; (4) monthly payment on any simultaneous loans secured by the same property; (5) monthly payment for property taxes and insurance the lender requires the consumer to buy; (6) debts, alimony, and child-support obligations; (7) monthly debt-to-income ratio or residual income; and (8) credit history.[228] The rule provides a private right of action, allowing borrowers to seek actual damages, statutory damages, costs, attorney's fees, and special damages equal to the finance charges and fees incurred.[229]

Both QM and the Proposal have similar goals: curbing predatory lending practices and protecting consumers.[230] QM incentivizes lenders to extend safer mortgages, primarily less risky ones, by permitting lenders to avoid conducting ATR tests and other regulations.[231] QM reduces the likelihood that a lender would extend a mortgage where the borrower lacks the ability to repay a mortgage with predatory characteristics.[232]

The Independent Community Bankers of America ("ICBA") suggest utilizing a safe harbor provision that focuses on the lender, in contrast to the principal payoff option, which focuses on the borrower's financial standing.[233] This safe harbor would apply to banks whose loans perform above a certain threshold or do not possess risky and predatory lending characteristics.[234] This modification encourages banks to act responsibly by providing an opportunity to issue payday loans without conducting an ATR test.[235] The safe harbor proposed by

228. *Id*.

229. Sanford Shatz, *An Overview of the Consumer Financial Protection Bureau's Ability-to-Repay and Qualified Mortgage Rule*, A.B.A., http://www.americanbar.org/publications/blt/2013/04/02_shatz.html (last visited Jan. 20, 2017).

230. Payday, Vehicle Title, and Certain High-Cost Installment Loans, 81 Fed. Reg. 47,863, 47,898 (proposed July 22, 2016) (to be codified at 40 C.F.R. pt. 1041); Nicole Olvera, *Why the CFPB Should Reconsider Dodd-Frank's Prohibition on Yield Spread Premiums*, 16 N.C. BANKING INST. 323, 347 (2012).

231. Davis Reiss, *Message in a Mortgage: What Dodd-Frank's "Qualified Mortgage" Tells Us About Ourselves*, 31 REV. BANKING & FIN. L. 717, 721 (2012).

232. Christine Daleiden, *Financial Reform for Consumers: An Overview of the Dodd-Frank Act and the Consumer Protection Bureau*, 15 HAW. B.J. 4, 6–7 (2011).

233. Ware, *supra* note 128, at 9–10.

234. Ware, *supra* note 128, at 9–10.

235. Ware, *supra* note 128, at 2.

the ICBA incentivizes banks to enter the marketplace by allowing banks to avoid compliance costs, thus reducing concerns over profitability.[236] As a matter of basic policy, responsible lenders should be subject to a lesser standard that recognizes their history of responsible lending practices and emphasis on greater consumer protection.[237] The CFPB should be encouraging borrowers to transact with responsible lenders, rather than broadly imposing burdens on all lenders who provide payday loans.[238]

The National Credit Union Administration ("NCUA") advocates for exempting lenders from being required to conduct ATR tests for loans where the total payment owed does not exceed 5% of the borrower's gross monthly income.[239] This threshold arguably satisfies the goals of the ATR test in a less complex manner.[240] Exempting loans with less than a 5% debt-to-income ratio reduces compliance and overall transactional costs in two ways: (1) lenders avoid conducting ATR tests and (2) borrowers are less likely to default on or rollover loans with a low debt-to-income ratio, thereby reducing default-related expenditures.[241] Additionally, loans extended at a low debt-to-income ratio are not the primary target of the Proposal,[242] since borrowers are more likely to be able to repay these loans while also covering basic living expenses, which is what the Proposal aims to achieve.[243] This safe harbor increases the effectiveness and efficiency of the Proposal in curbing risky loans, while also encouraging banks to enter the

236. Ware, *supra* note 128, at 2.

237. Comment Letter from Credit Union Nat'l Ass'n to Monica Jackson, Off. of the Exec. Sec'y, Consumer Fin. Prot. Bureau 6 (Oct. 5, 2016), http://www.cuna.org/uploadedFiles/CUNA/Legislative_And_Regulatory_Advocacy/Track_Regulatory_Issues/Pending_Regulatory_Changes/2016/CUNA%20Comment%20Small%20Dollar%20Loans%20Final%20Letter%20attachments%2020161005.pdf.

238. *Id.*

239. Comment Letter from Rick Metsger, Chairman, Nat'l Credit Union Admin., to Monica Jackson, Off. of the Exec. Sec'y, Consumer Fin. Prot. Bureau 2 (Oct. 3, 2016), https://www.ncua.gov/newsroom/Documents/comment-letter-2016-oct-metsger-payday-rule.pdf; Comment Letter from Douglas Levy, Pres. & CEO, Guaranty Bank, to Richard Cordray, Dir., Consumer Fin. Prot. Bureau (Sept. 28, 2016), https://www.regulations.gov/document?D=CFPB-2016-0026-0186.

240. *Id.*

241. *Id.*

242. *Id.*

243. Zachary B. Marquand, *Ability to Repay: Mortgage Lending Standards After Dodd-Frank*, 15 N.C. BANKING INST. 291, 301–02 (2011).

marketplace by reducing banks' fears over profitability.[244]

VI. CONCLUSION

The CFPB's Proposal aims to eliminate payday lending practices that often force borrowers into repeated, long-term use of payday loans. While the Proposal is designed to actively address issues surrounding repeat borrowing, sustained use, and harmful debt collection practices, the Proposal may also significantly reduce consumer access to credit by regulating many lenders out of the marketplace. One potential solution to this issue is to encourage traditional banks to enter the payday loan marketplace by reducing the Proposal's compliance costs. Expanding the principal payoff option by creating additional exemptions from the ATR test requirements can encourage these depository institutions to offer more consumer-friendly products in this area. Creating safe harbors and maintaining adequate degrees of consumer protection are not mutually exclusive goals. Finally, by encouraging and supporting banks' exploration of new products similar to payday loans, banks will be more likely to enter the marketplace and provide borrowers with safer access to short-term credit, even if the Proposal does not come to fruition.

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244. Metsger, *supra* note 239, at 2.

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